Government of Newfoundland and Labrador
Department of Finance

Newfoundland and Labrador
Government Sinking Fund

Annual Performance Report 2011-12

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BOARD OF TRUSTEES
NEWFOUNDLAND AND LABRADOR CONSOLIDATED SINKING FUNDS

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION SINKING FUND
P.O. BOX 8700
ST. JOHN'S, NL
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DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING

September 21, 2012

Message from the Board

I am pleased to present the Annual Performance Report for the Newfoundland and Labrador Government Sinking Fund for the 2011-12 fiscal year.

The Newfoundland and Labrador Government Sinking Fund administers the sinking funds established by the Province of Newfoundland and Labrador for the repayment of the Province's debenture debt. The effective investment and control of these funds is consistent with the Department's responsibilities with respect to stewardship of public money and management of the funded debt and supports the Department's strategic direction and commitment to sound financial management.

This performance report provides an overview of the Newfoundland and Labrador Government Sinking Fund and identifies key issues and results for the Board of Trustees during the fiscal year 2011-12. The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $52.9 million during 2011-12, which was net of a foreign exchange gain of $0.9 million, resulting from an increase in the value of the U.S. dollar.

The Board of Trustees is accountable for the preparation of this report and for the results reported therein.

Laurie Skinner
Chairperson

1.0 Overview

The Newfoundland and Labrador Government Sinking Fund was created pursuant to the *Financial Administration Act* to consolidate and administer sinking funds established for the repayment of the Province's debenture debt. The Province has established sinking funds for most of its long term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees of the Newfoundland and Labrador Consolidated Sinking Funds, appointed by the Lieutenant Governor in Council to manage and control the day to day operation of the sinking funds. As at 31 March 2012, the Board of Trustees consists of the incumbents in five senior public service positions with the Department of Finance as follows:

Terry Paddon	Deputy Minister
Ronald Williams	Comptroller General
Laurie Skinner	Assistant Deputy Minister Taxation and Fiscal Policy
Paul Myrden	Director, Debt Management
Linda Howell	Manager of Debt Servicing & Financial Risk

The Newfoundland and Labrador Government Sinking Fund operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

2.0 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the Newfoundland and Labrador Government Sinking Fund and the sinking funds of certain crown corporations where the Province has guaranteed the related debt (i.e. Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the *Financial Administration Act,* primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, the government of a province of Canada, or a chartered bank, with the goal of earning the maximum return from investment of the portfolio while ensuring security of the funds.

3.0 Support of Vision and Mission of Department

The vision of the Department of Finance is of a vibrant and self-reliant economy and prosperous people and is supported by the Newfoundland and Labrador Government Sinking Fund. The mission of the Department of Finance is to support Government in its commitment to fiscal sustainability and a healthy economy for the Province. The Newfoundland and Labrador Government Sinking Fund continues to follow the mission of the Department by supporting the Province's fiscal management through the prudent management and investment of Sinking Fund assets.

4.0 Sources of Funding

For debenture issues which have sinking fund requirements, the Province makes the required sinking fund contributions to the operating bank account managed by the Board of Trustees. In 2011-12, these sinking fund payments amounted to $48,554,000. Sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Province for reimbursement of these expenses on a cost-recovery basis.

5.0 Financial Statements

The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $52.9 million during 2011-12, after a foreign exchange gain of $0.9 million, resulting from an increase in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that the U.S. assets are converted to Canadian dollars. Special purpose financial statements for the year ending 31 March 2012 are included in this report.

6.0 2011-14 Activity Plan Update

The Newfoundland and Labrador Government Sinking Fund supports the Department of Finance in its responsibilities related to stewardship of public money and fiscal management by the investing of funds in accordance with parameters set out in the *Financial Administration Act* and the Department's mandate and mission statement. The unpredictable nature of the investment market continues to challenge the Board of Trustees in its mandate to ensure that the investment strategy maximizes the rate of return

earned on its investment portfolio, while at the same time, protects the security of the sinking funds.

Under policy in effect during 2011-12, surplus sinking funds (i.e. for each particular provincial loan outstanding, the amount of a sinking fund's value over the amount of related debt outstanding) are returned to the Province annually. Prior to 1999, when this policy was brought into effect, all surplus funds were left in the overall Newfoundland and Labrador Government Sinking Fund, to apply against other loans outstanding. As outlined in the progress report below, the Board reviewed this policy and approved a change whereby, beginning in the 2012-13 fiscal year, sinking fund net income will be allocated only to those sinking funds which are not fully funded.

Goal By March 31, 2014, the Newfoundland and Labrador Government Sinking Fund will have continued prudent investment of the fund's assets.

Measure:

Invested fund assets

Indicators:

Continued prudent investment

Objectives

1. By March 31, 2012, the Newfoundland and Labrador Government Sinking Fund Board will have ensured prudent investment of the assets of the Fund, reviewed the policy of repayment of the surplus sinking funds, and implemented any approved changes to the policy.

Measure: Ensured prudent investment, reviewed the policy, and implemented any approved changes.

Indicators:

- Completed policy review and approved changes
- Prudently invested the assets of the Fund in accordance with the *Financial Administration Act*
- Completed review of periodic reports to the Board

Progress: The Board reviewed the policy of annual repayment of surplus sinking funds to the Province and approved a change to the policy whereby, beginning in the 2012-13 fiscal year, sinking fund net income will be allocated only to those sinking funds which are not fully funded. This will allow faster growth to those sinking funds that are not fully funded, will lessen the Province's debt burden as the related loans mature, and will allow for earlier relief for the Province of statutory contributions to a sinking fund, as

a sinking fund becomes fully funded earlier. The new policy will also eliminate future sinking fund surpluses.

The Board also completed a review of periodic reports to the Board, ensuring that the assets of the Fund were prudently invested in accordance with the *Financial Administration Act*.

Objective - 2012-13:

As of March 31, 2013, the Newfoundland and Labrador Government Sinking Fund will have continued prudent investment of the assets of the Fund.

Measure:

Invested Fund Assets

Indicators:

- Prudent investment of the assets of the Fund in accordance with the *Financial Administration Act*
- Review of periodic reports to the Board

7.0 Highlights and Accomplishments

During the year 2011-12 the Sinking Fund had a net income of approximately $52.9 million.

8.0 Opportunities and Challenges

The unpredictable nature of the investment market will continue to challenge the Board of Trustees to ensure that its investment strategy maximizes the rate of return earned on its investment portfolio while at the same time, protects the security of the sinking funds.

A slow global recovery is expected to continue in 2012. As the world economy improves, it is anticipated that there will be an opportunity to increase the earning potential of the investment portfolio.

Financial Statements

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

FINANCIAL STATEMENTS

31 MARCH 2012

OFFICE OF THE AUDITOR GENERAL
St. John's, Newfoundland and Labrador

AUDITOR'S REPORT

To the Board of Trustees of the
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

Report on the Financial Statements

I have audited the accompanying financial statements of the Newfoundland and Labrador Government Sinking Fund which comprise the balance sheet as at 31 March 2012, and the statements of statutory contributions, retained earnings, revenues and expenses, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting policies described in Note 1 to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Auditor's Report (cont.)

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newfoundland and Labrador Government Sinking Fund as at 31 March 2012, and its financial performance and its cash flows for the year then ended in accordance with the accounting policies described in note 1 to these financial statements.

Basis of accounting

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador to meet their information needs under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds. These financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

Sandra Russell

SANDRA RUSSELL, CA
Deputy Auditor General

28 September 2012
St. John's, Newfoundland and Labrador

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
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31 March 2012

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NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND

BALANCE SHEET

As at 31 March

	2012 (000's)	2011 (000's)
ASSETS		
Current		
Cash	$ 25,180	$ 22,268
Term deposits and short-term investments	-	6,011
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	9,812	9,376
Other	3,635	3,416
	38,627	41,071
Investments, at amortized cost (Schedule 1)		
Cost	798,694	768,799
Accumulated amortization of discounts and premiums	75,781	114,723
	874,475	883,522
	$ 913,102	$ 924,593
LIABILITIES AND SINKING FUND EQUITY		
Current		
Accounts payable and accrued liabilities	$ 12	$ 11
Due to Province of Newfoundland and Labrador	195	259
	207	270
Sinking fund equity		
Statutory contributions (Statement 2)	529,302	525,239
Retained earnings (Statement 3)	383,393	399,084
	912,895	924,323
	$ 913,102	$ 924,593

See accompanying notes

Signed on behalf of the Board: Laurie Skinner
Chairperson

Member

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS
For the Year Ended 31 March

	2012	2011
	(000's)	(000's)
Balance, beginning of year	**$ 525,239**	$ 487,319
Statutory contributions for the year	**48,554**	48,352
	573,793	535,671
Statutory contributions applicable to matured/redeemed debentures	**(48,190)**	(4,311)
Foreign currency translation adjustment (Note 2)	**3,899**	(6,121)
Balance, end of year	**$ 529,502**	$ 525,239

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS
For the Year Ended 31 March

	2012	2011
	(000's)	(000's)
Balance, beginning of year	**$ 399,084**	$ 368,915
Excess of revenues over expenses	**52,918**	47,951
	452,002	416,866
Retained earnings applicable to matured/redeemed debentures	**(72,037)**	(12,016)
Foreign currency translation adjustment (Note 2)	**3,428**	(5,766)
Balance, end of year	**$ 383,393**	$ 399,084

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended 31 March

	2012	2011
	(000's)	(000's)
REVENUES		
Interest income		
Debentures	$ 39,725	$ 37,072
Term deposits and short-term investments	4	34
Other	382	348
	40,111	37,454
Foreign currency translation gains (losses) (Note 2)	851	(1,203)
Amortization of discounts and premiums	12,228	12,300
Loss on redemption/sales	-	(342)
	53,190	48,209
EXPENSES		
Salaries and benefits	160	152
General	112	106
	272	258
Excess of revenues over expenses	$ 52,918	$ 47,951

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS
For the Year Ended 31 March

	2012	2011
	(000's)	(000's)
Cash flows from operating activities		
Excess of revenues over expenses	$ 52,918	$ 47,951
Adjustment for non-cash items		
Amortization of discounts and premiums	(12,228)	(12,300)
Foreign currency translation (gains) losses (Note 2)	(851)	1,203
Loss on redemption/sales	-	342
	39,839	37,196
Change in non-cash working capital	(718)	(569)
	39,121	36,627
Cash flows from financing activities		
Statutory contributions	48,554	48,352
Cash flows from investing activities		
Purchase of investments	(93,002)	(100,401)
Proceeds from redemption and sale of investments	122,014	-
Payments of excess to Province upon maturing debentures	(120,227)	(6,065)
	(91,215)	(106,466)
Net decrease in cash and cash equivalents	(3,540)	(21,487)
Effect of foreign currency translation adjustment (Note 2)	441	(1,657)
Cash and cash equivalents, beginning of year	28,279	51,423
Cash and cash equivalents, end of year	$ 25,180	$ 28,279
Cash and cash equivalents include:		
Cash	$ 25,180	$ 22,268
Term deposits and short-term investments	-	6,011
	$ 25,180	$ 28,279

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS
31 March

	2012		2011	
	Face Value or Par (000's)	**Amortized Cost (000's)**	Face Value or Par (000's)	Amortized Cost (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**$ 143,660**	**$ 152,429**	$ 143,660	$ 153,106
Newfoundland and Labrador Municipal Financing Corporation	**4,581**	**4,595**	19,350	19,346
Health Care Corporation (Eastern Health)	**7,000**	**9,953**	-	-
Newfoundland and Labrador Hydro	**30,248**	**35,379**	30,248	35,678
Coupons and residuals	**260,509**	**150,497**	311,940	191,488
	445,998	**352,853**	505,198	399,618
Other securities	**103,167**	**108,833**	110,760	115,994
Other coupons and residuals	**231,764**	**113,613**	185,963	98,473
	780,929	**575,299**	801,921	614,085
U.S.				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**130,128**	**145,351**	120,477	134,534
Other securities	**111,302**	**137,219**	97,080	120,205
Other coupons and residuals	**24,543**	**16,606**	23,121	14,698
	265,973	**299,176**	240,678	269,437
Total investments	**$ 1,046,902**	**$ 874,475**	$ 1,042,599	$ 883,522

See accompanying notes

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act.* All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

1. Basis of accounting

These financial statements have been prepared by the Newfoundland and Labrador Government Sinking Fund in accordance with the summary of significant accounting policies set out below to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds.

The basis of accounting used in this report may materially differ from Canadian generally accepted accounting principles because the report does not represent general purpose financial statements.

Summary of significant accounting policies

These financial statements have been prepared on the accrual basis of accounting. Outlined below are the significant policies followed.

(a) Cash and cash equivalents

Cash and cash equivalents include balances with banks, and term deposits and short-term investments with original maturities of three months or less.

Short-term deposits are recorded at cost which approximates market value because of the short-term nature of the securities.

1. Basis of accounting (cont.)

Summary of significant accounting policies (cont.)

(b) Investment transactions

(i) Purchases: Investments are initially recorded at cost.

(ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.

(iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.

(iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

(c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided

(i) General

Provision is made for redemption at debenture maturity by investing statutory contributions in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The dollar total of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At maturity, statutory contributions are reduced by the total amount of statutory contributions received over the life of the issue. Retained earnings are reduced by the excess of the debenture's Sinking Fund Value over statutory contributions received.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the issue held in the Fund's investments. If the issue's Sinking Fund Value exceeds the total face value, the excess is paid to the Consolidated Revenue Fund of the Province of Newfoundland and Labrador. If the issue's Sinking Fund Value is less than the total face value, the difference is paid into the redemption bank account by the Province.

1. **Basis of accounting (cont.)**

Summary of significant accounting policies (cont.)

(d) Cancellation of Province of Newfoundland and Labrador debentures held by the Sinking Fund upon related sinking fund debentures becoming fully funded

When the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue, the Sinking Fund will return to the Province for cancellation any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity. Interest income continues to be allocated to the sinking fund until maturity of the related debenture issue and is returned to the Province annually.

(e) Interest income

Interest income is recorded on an accrual basis.

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

(i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and

(f) Foreign currency translation (cont.)

(ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. **Effect of foreign currency translation**

At 31 March 2012, the Fund held $874,475,000 (2011 - $883,522,000) in investments as shown in Schedule 1. These investments include $299,176,000 in U.S. investments (2011 - $269,437,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

2. Effect of foreign currency translation (cont.)

In 2012, the translation of U.S. assets at year end resulted in a net foreign exchange gain due to an increase in the value of the U.S. dollar. In 2011, the translation of U.S. assets at year end resulted in a net foreign exchange loss due to a decrease in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that U.S. assets should ever actually be converted to Canadian dollars.

	2012 (000's)	2011 (000's)
The effect of the translation is as follows:		
Statutory contributions have been increased (decreased) by	$ 3,899	$ (6,121)
Retained earnings have been increased (decreased) by	3,428	(5,766)
Excess of revenues over expenses has been increased (decreased) by	851	(1,203)
Total impact of foreign currency translation	8,178	(13,090)
The effect of this amount on the Fund assets is as follows:		
Investments have been increased (decreased) by	7,737	(11,433)
Cash and cash equivalents have been increased (decreased) by	$ 441	$ (1,657)

3. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, term deposits and short-term investments, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund holds long-term investments which have an amortized cost of $874,475,000 (2011 - $883,522,000). The face value of these investments is $1,046,902,000 (2011 - $1,042,599,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no rate risk associated with these investments.

4. Income taxes

The Newfoundland and Labrador Government Sinking Fund is a Crown entity of the Province of Newfoundland and Labrador and as such is not subject to Provincial or Federal income taxes.